

BEFORE THE
STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

RECEIVED
APR 20 1999
FCC MAIL ROOM

SBC COMMUNICATIONS INC.,)
SBC DELAWARE INC.,)
AMERITECH CORPORATION,)
ILLINOIS BELL TELEPHONE COMPANY,)
d/b/a AMERITECH ILLINOIS, and)
AMERITECH ILLINOIS METRO, INC.)

Docket 98-0555

Joint Application for approval of the)
reorganization of Illinois Bell Telephone)
Company, d/b/a Ameritech Illinois, and the)
reorganization of Ameritech Illinois Metro, Inc.)
in accordance with Section 7-204 of The Public)
Utilities Act and for all other appropriate relief.)

REBUTTAL TESTIMONY OF CHARLOTTE F. TERKEURST
ON BEHALF OF
THE GOVERNMENT AND CONSUMER INTERVENORS

The People of the State of Illinois
The People of Cook County
Citizens Utility Board

GCI Ex. 2.1

December 18, 1998

REBUTTAL TESTIMONY OF CHARLOTTE F. TERKEURST
ON BEHALF OF THE GOVERNMENT AND CONSUMER INTERVENORS

DOCKET 98-0555

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	EFFECTS ON PUBLIC UTILITY SERVICE—SECTION 7-204(B)(1).....	7
A.	Network Investment and Modernization.....	7
B.	Job Creation and Retention	11
C.	New and Improved Services and Products.....	15
D.	Marketing Practices.....	17
E.	Need for Service Quality Safeguards	19
III.	EFFECTS ON COMPETITION—SECTION 7-204(B)(6).....	24
A.	Current Status of Local Competition.....	28
B.	Effects of Corporate "Attitude" on Competition.....	32
C.	Effect of Merger on Competition in Illinois	33
D.	Need for Competitive Safeguards	35
IV.	REFLECTION OF MERGER BENEFITS IN RATES—SECTION 7-204(C).....	39

1 REBUTTAL TESTIMONY OF CHARLOTTE F. TERKEURST

2 ON BEHALF OF THE GOVERNMENT AND CONSUMER INTERVENORS

3 DOCKET 98-0555
4
5

6 I. INTRODUCTION

7
8 Q. Please state your name and business address.

9 A. My name is Charlotte F. TerKeurst and my business address is 70 E. Lake Street, 7th
10 Floor, Chicago, Illinois 60601.
11

12 Q. Are you the same Charlotte F. TerKeurst who submitted direct testimony in this
13 proceeding?

14 A. Yes.
15

16 Q. What is the purpose of your rebuttal testimony?

17 A. I respond to various statements made by other parties in their testimony, with the primary
18 focus being on the rebuttal testimony filed by SBC and Ameritech Illinois witnesses. For
19 convenience, my rebuttal testimony follows the general structure of my direct testimony.
20

21 Q. Are there overarching themes to SBC's and Ameritech Illinois' rebuttal testimony that
22 warrant separate discussion?

23 A. Yes. There are three recurring themes in the Applicants' rebuttal testimony: that the
24 Commission should approve this merger because it is in the best interest of SBC and
25 Ameritech Illinois; that a merger between SBC and Ameritech Illinois would create a
26 company of exactly the right size and capabilities to trigger an avalanche of competition

1 throughout the country; and that it would be inappropriate for the Commission to even
2 consider in this proceeding, let alone adopt, any conditions on the merger.

3
4 Regarding the first point, SBC witness Robert G. Harris states that:

5 The fact that these firms are responding to marketplace circumstances means that
6 the merger is beneficial from a (sic) economic standpoint and, indeed, is
7 consistent with the kinds of marketplace actions that policy makers want to
8 encourage, not discourage. Mergers such as this one strengthen our economy and
9 contribute to the economic growth and prosperity of our country. These
10 macroeconomic effects are important considerations in looking at the overall
11 beneficial impact of the merger. These are two private business firms who can
12 and want to improve their efficiency and competitiveness. Denying the merger
13 would be counter to the normal operation of marketplace forces. I think it is a
14 very significant action for public policy makers to even consider interfering with
15 the marketplace forces in our economy and believe that it would be a serious
16 mistake in the instant case.¹
17

18 This view that SBC's and Ameritech's own private interests are coterminous with the
19 best interests of the marketplace and the economy is rather astounding. With this view,
20 there would have been no need for the "interfering" market-opening actions taken by the
21 Commission over the past years or for the "interfering" nationwide mandates in the
22 Telecommunications Act of 1996 ("the 1996 Act"). For that matter, there would be no
23 need for antitrust review or the breakup of the Bell system almost fifteen years ago.

24
25 Dr. Harris' view is mirrored, on a more detailed level, by the Applicants' repeated
26 arguments that the Commission should approve this merger because it would strengthen
27 the Applicants' ability to compete and that residential and small business customers are
28 served by steps that allow Ameritech Illinois to strengthen its market share. In reviewing
29 the proposed merger, it is essential that the Commission take a broader view and evaluate

1 whether the merger would contribute to a market structure that would protect customers
2 and allow competition to develop.

3
4 Regarding the second point, SBC and Ameritech assert that their merger would give them
5 just the right amount of base territory and revenues to foray into the rest of the country.
6 They assert that neither of them would have the resources for such an undertaking alone,
7 and appear to be content with the idea that they would not need any additional merger
8 partners (although that remains to be seen). At the same time, the Applicants argue that,
9 even though current market conditions have not led incumbent local exchange carriers
10 ("ILECs") and certain competitive local exchange carriers ("CLECs") to enter Ameritech
11 Illinois' territory, the National-Local Strategy would trigger retaliatory responses by such
12 carriers. The concept that retaliatory entry would increase the amount of competition is
13 also at odds with the Applicants' stated intent that the merger would allow them to
14 maintain their own market share.

15
16 Finally, SBC and Ameritech Illinois summarily dismiss, over and over, any suggestions
17 that the Commission consider imposing any conditions on the merger. Aside from their
18 views that conditions are not needed, they repeatedly challenge the ability of the
19 Commission to even consider conditions in this proceeding. SBC and Ameritech Illinois
20 witnesses argue that quality of service measurements and standards should be considered
21 only in a rulemaking with statewide applicability, that service quality incentives should
22 be considered only in the review of Ameritech Illinois' alternative regulation plan, that
23 the Commission should defer to the Department of Justice ("DOJ") in analyzing the

¹ SBC/Ameritech ("SBC/AI") Ex. 4.1 at 40.

1 effects of the merger on competition, that requirements that Ameritech Illinois open its
2 local markets should not be considered, that restrictions on SBC's ability to unilaterally
3 change Ameritech Illinois' current Operations Support Systems ("OSS") should not be
4 considered in this proceeding, and that the Commission should not consider allocating
5 any merger synergies to customers.

6
7 While I am not an attorney, these repetitive assertions that the Commission does not have
8 the authority or that it would be inappropriate for the Commission to consider certain
9 mitigating conditions in this proceeding run counter to my understanding of the
10 Commission's responsibility, which is to determine whether the merger would meet the
11 requirements of Section 7-204 of the Public Utilities Act and whether any conditions
12 need to be imposed in order to allow it to make the findings required by Section 7-204.

13 While the attorneys will address the legal points during the briefing process, I continue to
14 analyze the proposed merger from this perspective.

15
16 Q. Do you have additional thoughts regarding the Applicants' assertions that the merger
17 should be approved so that they can retain their market share for large business
18 customers?

19 A. Yes, I do. A thoughtful analysis of the Applicants' position makes clear the importance
20 of the timing of synergy-creating mergers among ILECs relative to the timing of
21 providing full and nondiscriminatory access to their local networks.

1 SBC witness James S. Kahan warns that, absent the merger, Ameritech Illinois will not
2 be able to compete for large business customers, asserting that:

3 It is terribly important for the residential and small business customers that
4 Ameritech Illinois have an opportunity to compete for and retain large business
5 customers on their network. These large business customers provide a
6 disproportionate contribution to the joint and common cost of providing
7 telecommunications services in Illinois. If Ameritech Illinois cannot compete for
8 these customers, the obligation to maintain the network will fall on the remaining
9 customers who will be primarily small business and residential customers. In
10 light of the fact that substantial part (sic) of the competition to date has been
11 focused on large business customers, this should be a significant concern to the
12 Illinois Commerce Commission and anyone interested in maintaining high
13 quality, low cost service for residential customers.²
14

15 Dr. Harris makes similar arguments, concluding that the merger would “reduce the risk
16 that ratepayers will be left responsible for the stranded assets of a company that is not
17 competitive in the global telecommunications market.”³ Mr. Kahan warns that denial of
18 the merger would “create the serious risk of degradations in service quality throughout
19 our networks”⁴ and that Ameritech’s loss of large business customers would stifle
20 innovation.⁵
21

22 SBC’s arguments boil down to something like this: “The only way to protect residential
23 and small business customers from rate increases, degraded service quality, and reduced
24 innovation is for the market structure to be such that we can retain market share for larger

² SBC/AI Ex. 1.1 at 94-96. Mr. Kahan recognizes that Ameritech Illinois’ price cap mechanism protects retail customers. I note however, that the price caps apply only to services that are classified as noncompetitive. For services that have been classified as competitive but for which Ameritech Illinois still retains some degree of market power, Ameritech Illinois can raise rates, whether to recover costs or simply to maximize profits. Further, Ameritech Illinois could request some type of rate relief within the price cap regime (such as its rate rebalancing proposal) or modification to the price cap mechanism itself. Thus, SBC’s argument that market share loss puts pressure on rates for residential and small business customers cannot be dismissed entirely.

³ SBC/AI Ex. 4.1 at 30-31.

⁴ SBC/AI Ex. 1.1 at 18.

⁵ Id., at 21-22.

1 business customers.” This view assumes that SBC would be allowed to raise residential
2 and small business rates to offset revenue losses if larger business customers go
3 elsewhere, and that residential and small business customers do not have competitive
4 alternatives that they could choose in order to avoid those higher rates. Through a variety
5 of actions, including this merger and court challenges to Section 271 of the 1996 Act,
6 SBC is pursuing such a market structure, in which it has not fully opened its local
7 markets and at the same time is achieving cost reductions that better allow it to ward off
8 the competition that is struggling to develop.

9
10 If the Commission were to agree that protection of incumbent carriers’ market share
11 should be a regulatory goal, a simpler way to achieve this goal would be direct
12 restrictions or prohibitions on competition, a public policy that has been rejected by the
13 Commission for many years and that is now counter to national policy as well.

14
15 Rather than protecting residential and small business customers through blessing a
16 market structure that would tend to preserve an incumbent carrier’s market share, a
17 sounder public policy is to create market conditions that allow competition to develop for
18 all classes of customers, as a more sustainable way to benefit residential and small
19 business customers. This would involve vigorous enforcement of requirements that
20 Ameritech Illinois provide full and nondiscriminatory access to its local network and
21 related functions.

1 When Ameritech Illinois' local network is irreversibly open to competition, a merger
2 such as the one currently proposed may not unduly harm the development of competition
3 and may appear desirable from a public interest perspective. However, approving the
4 merger prematurely would allow the company to strengthen its local market power and
5 would harm the further development of competition.

6
7 II. EFFECTS ON PUBLIC UTILITY SERVICE—SECTION 7-204(b)(1)

8
9 A. Network Investment and Modernization

10
11 Q. Please respond to SBC's rebuttal of your concerns regarding SBC's incentives to invest
12 in the network in Illinois.

13 A. Mr. Kahan asserts that it is "inconceivable" that SBC would not invest in Illinois,
14 pointing to the history of SBC's investment in California after the SBC/Pacific Telesis
15 merger.⁶ He contends further that SBC and Ameritech must maintain their networks "at
16 the most advanced level possible to remain competitive." Mr. Kahan argues, as a result,
17 that there is no reason for the Commission to require a network investment commitment,
18 as I have recommended, as a condition of the merger.⁷ Ameritech Illinois witness David
19 H. Gebhardt argues similarly that my recommendation that the Commission require a
20 network investment commitment is not an appropriate part of this proceeding, but could
21 be addressed in the alternative regulation plan review proceeding.⁸

22

⁶ Id., at 11.

⁷ Id., at 13.

1 While skimping on network investments may be inconceivable to Mr. Kahan, Dr. Harris
2 hypothesizes that one scenario (which he opposes) could lead to reduced network
3 investments in Illinois. Dr. Harris asserts that the allocation of merger savings to
4 ratepayers would likely pressure Ameritech Illinois to:

5 take additional steps to reduce costs in order to achieve profitability goals. For
6 example, to reduce costs beyond what could be achieved by merger efficiencies,
7 Ameritech likely would be pressured to significantly reduce the number of
8 employees throughout the organization. This could have the undesired effect of
9 constraining service quality in order to constrain costs or reducing Ameritech's
10 incentives to invest in Illinois.⁹
11

12 While Dr. Harris posits that investment constraints could arise if the Commission
13 requires that merger synergies be shared with customers, one could envision any number
14 of events that could constrain the Applicants' cash flow beyond their current projections.
15 As an example, they could sink significant investment in their National-Local Strategy
16 but not succeed in capturing market share and the resulting revenues they are projecting.
17 Mr. Kahan recognizes that the National-Local Strategy will entail "billions of dollars of
18 new spending" and that SBC and Ameritech "project negative cumulative cash flows and
19 earnings from the project for nearly a decade."¹⁰
20

21 Dr. Harris has pointed out that the shareholders of ILECs expect more stable returns than
22 do CLEC shareholders. At the same time, he has recognized the negative market
23 responses that MCI encountered in the face of planned local market losses.¹¹ Because
24 SBC's shareholders expect stable returns, SBC will be under even more pressure to meet

⁸ SBC/AI Ex. 3.1 at 106.

⁹ SBC/AI Ex. 4.1 at 47.

¹⁰ SBC/AI Ex. 1.1 at 57.

¹¹ SBC/AI Ex. 4.1 at 28-30.

1 shareholder demands. Short of abandoning the National-Local Strategy, SBC may look
2 elsewhere in its operations to reduce costs. Because of the risks involved in the National-
3 Local Strategy, it is entirely reasonable for the Commission to impose network
4 investment commitments as a condition if the merger is approved.
5

6 Q. Please respond to Mr. Gebhardt's assertion that Ameritech Illinois' investments cannot be
7 tracked on the basis of the services and products which benefit from the investment and
8 by geography, as you recommended in your direct testimony.

9 A. Mr. Gebhardt asserts that most of Ameritech Illinois' investments in network
10 infrastructure support the entire network and all services, and that tracking by individual
11 products and services could be done only in rare circumstances. He recognizes that
12 Ameritech Illinois could track the geographic dispersion of its investment, but questions
13 the value of such information. He argues that the costs of tracking and reporting the
14 investments on a geographic basis would exceed the informational value.¹²
15

16 Mr. Kahan argues that Ameritech Illinois will enhance its network in order to compete
17 with MCI and AT&T for large business customers and that those enhancements would
18 directly benefit residential customers, since the same network is utilized to provide
19 service to business and residential customers.¹³ This does not provide assurance,
20 however, that such network enhancements will be made throughout the state, when
21 competitive pressures (to the extent they exist) are very localized.
22

¹² SBC/AI Ex. 3.1 at 107.

¹³ SBC/AI Ex. 1.1 at 100.

1 SBC's recognition that network investment is made in response to competitive pressures
2 supports the need I have identified to track Ameritech Illinois' investments on a
3 geographic basis to monitor whether Ameritech Illinois is favoring areas with some
4 competition at the expense of those parts of the state where CLECs are not yet operating.
5 If the merger is approved, it is reasonable for the Commission to require that Ameritech
6 Illinois track and report the types of network investment and the geographic locations of
7 such investments, so the Commission can monitor Ameritech Illinois' network
8 investment and detect whether investment-related service concerns have materialized.

9
10 Q. Is the experience in California regarding changes in network investment and service
11 quality since the SBC/Pacific Telesis merger indicative of what may occur following an
12 SBC-Ameritech merger?

13 A. Not necessarily. Much of SBC's rationale for this merger is based on the ambitious
14 National-Local Strategy, which would require large capital investments and is projected
15 to cause negative cash flows for a number of years. SBC has not had such financial and
16 cash flow pressures during the period since its merger with Pacific Telesis. As a result,
17 the fact that SBC may have increased network investment levels in California and may
18 have taken steps to improve service quality there does not guarantee that such policies
19 would be extended to other states, or even continued in California, if SBC does undertake
20 the National-Local Strategy. This planned change in SBC's financial circumstances is a
21 compelling reason for the Commission to monitor Ameritech Illinois' network
22 investment, service quality, and employment levels carefully, and to strengthen the

1 financial incentives for Ameritech Illinois to meet its service quality commitments if the
2 merger is approved.

3
4 B. Job Creation and Retention

5
6 Q. Please respond to SBC's and Ameritech Illinois' rebuttal testimony regarding
7 employment impacts of the proposed merger.

8 A. Mr. Kahan claims that a combined SBC/Ameritech would require only 8 percent of its
9 combined management expertise to pursue the National-Local Strategy, whereas
10 Ameritech Illinois would have to divert approximately 36 percent of its management if it
11 were to undertake such a venture on its own.¹⁴ He claims that planned combination of
12 various headquarters functions will "free() up highly experienced managers who can,
13 without any diminution in the level of management expertise available in Illinois, help
14 staff" the National-Local Strategy.¹⁵

15
16 The argument that in-region downsizing could "free up" managers to redeploy to the
17 National-Local Strategy may have surface appeal. However, to my knowledge, SBC has
18 not represented outside of these proceedings that the National-Local Strategy would be
19 staffed by in-region managers who, but for the National-Local Strategy, would no longer
20 be needed. To the contrary, SBC statements stress the "much deeper pool of
21 management and employee talent" that the merger would create and that could be tapped

¹⁴ Id., at 59. See also SBC/AI Ex. 5.0 at 14.

¹⁵ SBC/AI Ex. 1.1 at 15. See also SBC/AI Ex. 5.0 at 15.

1 to implement the National-Local Strategy.¹⁶ Recognizing that down-sizing efforts, as a
2 generality, attempt to eliminate the least talented or least productive employees, I am
3 skeptical about the idea that SBC would staff a major new effort like the National-Local
4 Strategy only with managers who would otherwise have lost their jobs. It is more likely
5 that the "best and brightest" would be conscripted to the new, high-profile venture while
6 others are left behind to mind the home front.

7
8 Q. Please respond to the rebuttal testimony of SBC witness Karen E. Jennings regarding
9 employment changes in California after the SBC/Pacific Telesis merger.

10 A. Ms. Jennings highlights that SBC "increased the number of jobs in important customer
11 contact positions, such as network technicians who install and maintain service and
12 customer service representatives who directly interact with customers," citing that
13 employment in these categories has increased by 1,485 positions (over 13 percent) since
14 the merger.¹⁷

15
16 While the statistics quoted by Ms. Jennings may sound impressive on its face, further
17 scrutiny tells a different story. Ms. Jennings has conveniently lumped service technicians
18 and customer service representatives together in reporting employment changes. While
19 service technicians play a valuable role in ensuring that quality service is provided,
20 customer service representatives increasingly have functioned as sales personnel. I was
21 able to identify in my direct testimony that at least 825 Pacific Bell positions have been

¹⁶ FCC Merger Filing, affidavit of James S. Kahan at 28-29.

¹⁷ SBC/AI Ex. 5.0 at 11-12.

1 shifted to sales positions.¹⁸ This total is just for those shifts that were explicitly identified
2 by a Pacific Bell executive in a speech in which he emphasized the redirection of Pacific
3 Bell's work force to focus on sales. Because these shifts were described anecdotally, the
4 shift of Pacific Bell positions to sales-oriented customer service representatives may
5 account for the vast majority of the 1,485 combined total reported by Ms. Jennings.

6
7 SBC witness Charles H. Smith similarly combines technicians and service representatives
8 when he states that "Pacific Bell currently has open requisitions for 718 customer-facing
9 employees (Technicians and Service Representatives)."¹⁹ Without a breakdown between
10 those employees who ensure that quality network service is being provided and those
11 employees who function more and more as a sales force, this data regarding apparent job
12 openings may be no more than a reflection that Pacific Bell is continuing to increase its
13 sales force.

14
15 Q. Please respond to SBC's rebuttal testimony regarding the decision-making abilities of in-
16 state managers.

17 A. SBC witnesses stress that SBC's local management teams would have the authority to
18 manage business operations in their geographic areas.²⁰ That is well and good, but does
19 not change the fact that "general corporate goals, commitments and business principles
20 will be established at SBC's headquarters in San Antonio."²¹ The fact that regional
21 managers may have control over local operational, marketing, engineering, and product

¹⁸ GCI Ex. 2.0 at 17.

¹⁹ SBC/AI Ex. 6.0 at 31.

²⁰ SBC/AI Ex. 5.0 at 19.

²¹ Id.

1 introduction²² functions does not provide needed assurance that Illinois practices and
2 policies will not be overturned by SBC headquarters after the merger is consummated.
3 Nor is there any reason to believe that policy shifts that may have occurred in California
4 (e.g., the alleged shifts in focus to aggressive marketing) would not be repeated in
5 Illinois.

6
7 Ms. Jennings stresses that personnel who deal with customer service issues, i.e.,
8 installation, maintenance, repair, emergency response, and customer care personnel will
9 continue to be physically located in the communities they serve, stating that it is critical
10 that such employees "fully understand the customers they are serving and are accessible
11 to those customers."²³ It is not clear whether she would include customer service
12 representatives within her definition of "customer care personnel," but, as I have already
13 recommended in my direct testimony,²⁴ the Commission should require that customer
14 service representatives remain in the Ameritech region.

15
16 Q. Does Mr. Kahan characterize your position correctly when he states²⁵ that you "suggested
17 that SBC not be permitted to transfer managers and customer service representatives out
18 of Illinois"?

19 A. No. In my direct testimony, I stressed the need for the Commission to monitor changes
20 in Ameritech Illinois' employee levels. I in no way suggested that the Commission
21 prohibit transfers, but recommended instead that Ameritech Illinois be required to report

²² SBC/AI Ex. 6.0 at 2.

²³ SBC/AI Ex. 5.0 at 22.

²⁴ GCI Ex. 2.0 at 18.

²⁵ SBC/AI Ex. 1.1 at 111.

1 transfers of current employees out of Illinois, as part of the monitoring needed to assess
2 whether service quality is harmed as a result of the merger.²⁶

3
4 Q. Do you agree with Mr. Kahan's assertion²⁷ that your recommendations regarding staffing
5 and reporting conditions are "unnecessary and unwarranted micro-management"?

6 A. No. SBC has made various commitments to the Commission regarding its employment
7 practices, in recognition of the fact that this is a legitimate area of concern. I described in
8 my direct testimony why certain additional requirements should be imposed, including
9 the retention of customer service representatives in the Ameritech region. As I have
10 discussed, concerns regarding the financial pressures that the National-Local Strategy
11 will bring if it is pursued aggressively make it particularly important that the Commission
12 monitor SBC's post-merger employment policies and practices closely so that it can
13 identify any problem areas that may harm service quality.

14
15 C. New and Improved Services and Products

16
17 Q. Does Dr. Harris accurately portray your position when he states (through a question²⁸)
18 that you "contend that the merger will slow the release of advanced products to Illinois
19 consumers"?

20 A. No, he does not. In this section of my direct testimony, I agreed with SBC and Ameritech
21 that some efficiencies may be achieved in the joint development and testing of new
22 products and services, but expressed concern that other potential consequences could

²⁶ GCI Ex. 2.0 at 18.

²⁷ SBC/AI Ex. 1.1 at 112.

1 more than offset any such advantages.²⁹ Looking at the reference to my direct testimony
2 provided by Dr. Harris, I stated that "SBC and Ameritech's claim that their merger and
3 the resulting pooling of resources is necessary to support innovation is counter to
4 experience."³⁰ The remainder of that section explained why I reached these conclusions.
5 While an argument that the merger would speed innovation in Illinois is convenient for
6 SBC and Ameritech, I remain skeptical on this point.

7
8 Q. Please respond to Mr. Kahan's statements about your testimony regarding the risks of
9 pooling Ameritech's and SBC's research efforts.

10 A. Mr. Kahan states that he is "at a loss to understand how the presence or absence of more
11 or fewer major incumbents outside of Illinois" would have affected Illinois' pioneering
12 work in number portability and number pooling and accuses me of speculation when I
13 expressed concern that the effort would have been more difficult if SBC had owned
14 Ameritech Illinois.³¹ While I could speculate that SBC may have taken to heart the
15 advice of the Public Utility Commission of Texas that SBC should change its "corporate
16 attitude" toward CLECs,³² SBC's track record justifies the skepticism I have expressed
17 regarding the ability of Illinois to lead the nation in opening up local markets if SBC were
18 in control of Ameritech Illinois.

19

²⁸ SBC/AI Ex. 4.1 at 36.

²⁹ GCI Ex. 2.0 at 19.

³⁰ Id., at 21.

³¹ SBC/AI Ex. 1.1 at 24-25.

³² Investigation of Southwestern Bell Telephone Company's Entry into the Texas InterLATA Telecommunications Market, PPUC Project No. 16251, Commission Recommendation, Public Interest Recommendation No. 2.

1 Mr. Kahan erroneously states that I criticize the structure of Technology Resources, Inc.
2 (“TRI”).³³ What I said was that SBC has overstated the benefit that access to TRI would
3 bring to Ameritech Illinois, partly because of its role in supporting the activities of all of
4 SBC’s affiliates. That was not meant as a criticism, but rather as a realistic assessment of
5 TRI’s limitations.

6
7 D. Marketing Practices

8
9 Q. Please respond to SBC’s rebuttal testimony regarding SBC marketing practices.

10 A. Mr. Kahan states that SBC does not believe that “it is appropriate or reasonable for us,
11 this Commission or Ms. TerKeurst to act on the presumption that our customers are
12 incapable of making responsible decisions to choose whether to acquire and/or maintain
13 [services such as Caller ID and Call Waiting] from SBC.” I agree with Mr. Kahan that a
14 telephone company should be able to market its services to its customers. However, if a
15 company’s marketing practices are misleading or overly aggressive, customers are not
16 given the opportunity to make informed decisions. As I described in my direct testimony,
17 local exchange carriers play a continuing public utility role in educating customers and
18 misleading and overly aggressive sales tactics should not be tolerated.

19
20 Mr. Smith reports excerpts from Pacific Bell’s and SBC’s written internal policies that
21 direct employees to be truthful and not to misrepresent SBC’s services. Pacific Bell also
22 has a written policy that its service representatives must use the tariff names of all

³³ SBC/AI Ex. 1.1 at 25.

1 products discussed during service interactions.³⁴ These policies all sound commendable.
2 The proof is in how these policies are carried out, however. As described in my direct
3 testimony, complaints are pending before the California Public Utilities Commission in
4 which the various complainants allege a number of problems with Pacific Bell's
5 marketing practices, including that it misleadingly offers optional feature packages with
6 "basic" in the brand name.³⁵

7
8 In addition, I am aware of at least one service for which Pacific Bell's service
9 representatives do not use the tariff name during marketing contacts. As mentioned in
10 my direct testimony in this proceeding, I was involved earlier this year in a proceeding in
11 California regarding Pacific Bell's inside wiring services.³⁶ Pacific Bell offers a
12 regulated monthly inside wire service called WirePro, which is tariffed at \$0.60 per
13 month for residential customers. It came to light during the course of the California
14 proceeding that Pacific Bell recently began offering an unregulated service called
15 WireProPlus which, for \$1.65 per month, insures against the failure in a residential
16 customer's telephone equipment (CPE). However, in marketing to customers, Pacific
17 Bell misleadingly uses the term WireProPlus to refer to a bundled \$2.25 package of the
18 unregulated CPE service (which cannot be bought without the inside wire service) and
19 the regulated inside wire service. Service representatives do not inform customers that
20 the two services are separate or that they may purchase the inside wire WirePro service

³⁴ SBC/AI Ex. 6.0 at 24-27.

³⁵ GCI Ex. 2.0 at 31.

³⁶ In the Matter of the Application of Pacific Bell, a Corporation, for Authority to Categorize Business Inside Wire Repair, Interexchange Carrier Directory Assistance, Operator Assistance Service and Inmate Call Control Service as Category III Services, Application 98-02-017, consolidated with In the Matter of the Application of Pacific Bell, a Corporation, for Authority to Categorize Residential Inside Wire Repair, as Category III Services, Application 98-04-048, California Public Utilities Commission.

1 for only \$0.60 unless and until the customer rejects the \$2.25 package. This is an
2 example, of which I have personal knowledge, where Pacific Bell has misleadingly
3 named a CPE product WireProPlus and markets the regulated inside wire service on a
4 bundled basis without referring to its tariffed name.

5
6 E. Need for Service Quality Safeguards

7
8 Q. Please respond to Staff witness Samuel S. McClerren's recommendations regarding
9 modifications to the service quality index mechanism in Ameritech Illinois' alternative
10 regulation plan.

11 A. Mr. McClerren recommends that the existing penalty level be doubled (from 0.25 percent
12 to 0.50 percent) for every missed minimum service standard. In addition, if Ameritech
13 Illinois misses a service standard in consecutive years, the prior year's penalty would be
14 doubled in each consecutive year.³⁷ I have no objection to Mr. McClerren's basic
15 recommendation. However, as discussed in my direct testimony, I recommend that
16 additional service quality measurements be added to the service quality mechanism if the
17 merger is approved. I also recommend that the Commission make the needed changes to
18 the service quality index in this proceeding, as a condition of merger approval authorized
19 by Section 7-204, rather than deferring them to the proceeding reviewing the alternative
20 regulation plan.

21
22 Q. Please respond to Mr. Gebhardt's opposition to Mr. McClerren's service quality incentive
23 proposal.

1 A. Mr. Gebhardt complains that Mr. McClerren's service quality proposal would result in
2 penalties that are "grossly out of proportion to the gravity of the 'offense.'"³⁸ He
3 describes that, based on 1996 noncompetitive revenues, the reduction in the price cap
4 index in 1999 would result in annualized revenue reductions of \$65 million³⁹ and
5 calculates a cumulative revenue impact of \$150.7 million through 1999 if Mr.
6 McClerren's approach had been adopted and in place from the beginning of the
7 alternative regulation plan.⁴⁰ Mr. Gebhardt goes on to assert that, if the Staff's proposal
8 were to be considered, the out-of-service-over-24-hours standard would have to be
9 reassessed, the service quality penalty would have to be changed to an annual refund or
10 credit, and Ameritech Illinois' original proposal that it have the opportunity to obtain
11 increases to the price cap index if it exceeded the service quality standards would have to
12 be reassessed.⁴¹

13
14 First, it is important to note that Mr. Gebhardt's calculations regarding the financial
15 effects of Mr. McClerren's proposal are greatly exaggerated, since Ameritech Illinois has
16 reclassified a substantial number of services as competitive and thus outside the price cap
17 mechanism. In addition, Ameritech Illinois' repeated failure to meet the out-of-service-
18 over-24-hours standard stands as proof that the existing service quality penalty levels do
19 not provide adequate incentives currently for Ameritech Illinois to meet the standards.
20 Ameritech Illinois' ongoing service reclassifications will make the current service quality
21 mechanism even less effective. At the same time, the National-Local Strategy, with its

³⁷ ICC Staff Ex. 8.00 at 16.

³⁸ SBC/AI Ex. 3.1 at 100.

³⁹ \$1.625 billion 1996 noncompetitive service revenues x 4.0 percent. See SBC/AI Ex. 3.1, Schedule 4.

⁴⁰ SBC/AI Ex. 3.1 at 100.

1 increased risks and the potential pressure to cut in-region costs to meet corporate cash-
2 flow goals, makes it even more important that there be a strong, effective service quality
3 incentive mechanism. As a result, it is entirely appropriate for the Commission to
4 consider service quality incentives in this proceeding and, if the merger is approved, to
5 adopt modifications to the incentive mechanism as a merger condition consistent with
6 Section 7-204.

7
8 Q. Please respond to SBC's and Ameritech Illinois' opposition to the recommendations you
9 made in your direct testimony regarding service quality measures and incentives.

10 A. Mr. Gebhardt states that, while he does not disagree that the Commission may want to
11 revisit its rules regarding service standards, this should be done only in a rulemaking
12 proceeding with any new standards applicable industrywide. He states that Ameritech
13 Illinois would not object to conforming the service quality measurements in its alternative
14 regulation plan to new industrywide standards as part of the proceeding in which the
15 alternative regulation plan is being reviewed.⁴²

16
17 Mr. Gebhardt asserts that the Citizens Utility Board ("CUB"), through my testimony in
18 this proceeding, "is apparently trying to end-run a decision by raising [its proposals made
19 in Docket 96-0178] in this proceeding as well." He argues that, since these proposals go
20 beyond what is in the alternative regulation plan and beyond what is in the Commission's
21 existing standards of service rule, it is "totally inappropriate for CUB to raise them here."
22 He then states that his response to my proposal is the same as his response to the Staff's

⁴¹ Id., at 101-102.

⁴² Id., at 104.

1 proposal to increase the service quality penalties in the price cap plan.⁴³ SBC witnesses
2 Kahan and Richard R. Galloway express similar sentiments.⁴⁴

3
4 Ameritech Illinois makes largely procedural arguments, claiming that this is not the
5 appropriate proceeding for the Commission to consider service quality measurements,
6 reporting requirements, and changes to the service quality incentive mechanism. There
7 are several reasons why Ameritech Illinois' arguments should be rejected. First, Mr.
8 Gebhardt's point that proposals to alter service quality measurements should be made in a
9 generic rulemaking applicable industrywide ignores the fact that the company's own
10 price cap plan established service quality standards for Ameritech Illinois that differ from
11 those applied to other Illinois ILECs. In its Order establishing the price cap plan, the
12 Commission noted:

13 Section 5/13-506.1(b)(6) requires the Commission to find that an alternative
14 regulation plan will **maintain** the quality and availability of telecommunications
15 services (emphasis added by the Commission). The Commission believes that the
16 best way to eliminate the Company's incentive to reduce service quality will be to
17 adopt a service quality component which penalizes the Company for not
18 maintaining service quality but does not provide additional reward for exceeding
19 current performance. Therefore, we will adopt the Company's eight separate
20 quality of service measures using the Company's average actual performance in
21 1990 and 1991 as performance benchmarks. Since the Company has exceeded
22 the Commission's Part 730 rules, which are intended to be minimum standards
23 which all LECs must satisfy, it is necessary to establish these higher standards to
24 safeguard against erosion of service quality.⁴⁵

25
26 Accordingly, there is no justification for asserting that proposals for quality of service
27 standards to be applied to Ameritech Illinois cannot or should not differ from those
28 followed by other ILECs or that such new measurements must be applied industrywide.

⁴³ SBC/AI Ex. 3.1 at 103.

⁴⁴ SBC/AI Ex. 1.1 at 111; SBC/AI Ex. 8.0 at 11-12.

⁴⁵ Docket 92-0448 et al., Order, October 11, 1994, at 58.

1 This is especially true given the quality of service concerns associated with the proposed
2 merger of Ameritech and SBC.

3
4 The notion that the Commission should wait until Ameritech Illinois' price cap review
5 docket to examine and alter the company's service quality measurements is equally
6 flawed. Mr. Gebhardt fails to mention that Ameritech Illinois has yet to file any
7 testimony in that proceeding.⁴⁶ If the Commission agrees with me that beefed-up service
8 quality measurements, reporting requirements, and incentives are needed in order for it to
9 find that service quality would not be harmed as a result of this merger (as required by
10 Section 7-204(b)(1)), the Commission should adopt such conditions in this proceeding if
11 the merger is approved.

12
13 Ameritech Illinois has had full opportunity to address this issue on a substantive basis,
14 but has chosen only to raise procedural arguments to date. This should not be used as
15 justification to defer adoption of the needed service quality conditions to another
16 proceeding, since such deferral would provide no assurance that the merger, if approved,
17 would not harm service quality.

18
19 Q. Do you agree with Mr. Kahan that reporting requirements regarding SBC implementation
20 of "best practices" would be anticompetitive and unfair⁴⁷?

⁴⁶ The Commission made clear in the Order in Docket 92-0448 that the price cap plan must be revisited before October 1999, when the five-year period for which it was adopted ends (see pages 64-65 and Appendix 1, p. 10 of the Order). However, Ameritech Illinois is not moving forward according to that schedule.

⁴⁷ SBC/AI Ex. 1.1 at 112.

1 A. No. The ability to monitor merger implementation is essential, if the Commission is to
2 find that the merger would not harm service quality. Information regarding the
3 implementation of what SBC views as companywide "best practices" is an important
4 component of such monitoring. It may be reasonable, however, for the Commission to
5 allow that such information be submitted on a confidential basis.

6
7 Q. Does Dr. Harris correctly characterize your direct testimony when he states (in the form
8 of a question) that you "allege that service quality will decline because of SBC's use of
9 the efficiency savings to enter new markets"?

10 A. No, he does not. Referring to the portion of my direct testimony which Dr. Harris
11 references,⁴⁸ I said that "(t)here is significant concern that SBC may allow the quality of
12 service and the level of network investment in Ameritech states to deteriorate and use the
13 resulting cost savings for investments."⁴⁹ While it is not clear that service quality would
14 definitely decline post-merger, I have grave enough concerns to recommend several
15 service quality-related merger conditions, as explained elsewhere in my direct and
16 rebuttal testimony

17
18 III. EFFECTS ON COMPETITION—SECTION 7-204(b)(6)

19
20 Q. Please respond to SBC and Ameritech Illinois witnesses who recommend that the scope
21 of the Commission's inquiry in this proceeding regarding the development of local
22 competition should be limited.

⁴⁸ SBC/AI Ex. 4.1 at 35.

⁴⁹ GCI Ex. 2.0 at 4.

1 A. Mr. Kahan states categorically and dismissively that future or potential harm to
2 competition is not a proper subject for consideration in this proceeding.⁵⁰ Dr. Harris
3 states his understanding that the Commission is only required to find that there is no
4 impact on existing competition.⁵¹ Mr. Gebhardt states that it is “unnecessary and
5 unprecedented” for the Commission to address potential competition or concentration
6 ratios, that the DOJ has “a primary role in evaluating the impact of any merger on
7 competition, and that “(i)t makes little policy sense for a state regulatory commission
8 with limited expertise in this area to attempt to duplicate the DOJ’s responsibilities.”⁵²
9
10 Mr. Gebhardt and Mr. Kahan assert that a finding of compliance with Sections 251 and
11 271 of the 1996 Act is not an appropriate condition to be placed on this merger, arguing
12 that nothing in Section 7-204(b)(6) would permit imposition of such a requirement.⁵³
13 Mr. Gebhardt argues that a condition that Ameritech Illinois obtain long distance relief
14 would mean that “the Commission would effectively be delegating its responsibilities
15 under the PUA to the FCC.” He asserts that “any condition imposed on the merger which
16 requires completion of other, unrelated legal requirements, which cannot be
17 accomplished within the legislatively mandated approval period, would be inconsistent
18 with the legislature’s purpose in imposing such a time limit on the proceeding.”
19

⁵⁰ SBC/AI Ex. 1.1 at 46.

⁵¹ SBC/AI Ex. 4.1 at 50.

⁵² SBC/AI Ex. 3.1 at 6.

⁵³ Id., at 42; SBC/AI Ex. 1.1 at 109.

1 In response to my suggestion that it may be appropriate to require a finding that
2 Ameritech Illinois has complied with Sections 251 and 252 of the 1996 Act,⁵⁴ Mr.
3 Gebhardt argues that he “would expect all of the same problems to arise demonstrating
4 compliance with Section 251 as have arisen with respect to the checklist in Section 271 --
5 i.e., hotly litigated, interminable proceedings with issues that ultimately only the FCC can
6 decide.”⁵⁵

7
8 I will reiterate what should be self-evident: the Commission has a responsibility to
9 affirmatively make the findings required by Section 7-204(b) before it can approve the
10 proposed merger. It also has the authority to adopt any conditions under Section 7-204(f)
11 that may be needed to allow it to make the Section 7-204(b) findings. The fact that
12 certain issues may be considered in other dockets (e.g., in Docket 96-0178), for other
13 companies (e.g., through a rulemaking), in other contexts (e.g., review of the alternative
14 regulation plan), or by other agencies (e.g., the DOJ or the FCC) does not change in any
15 respect the Commission’s responsibilities or authority arising from Section 7-204.

16
17 The assertions by Mr. Kahan and Dr. Harris that the Commission should somehow limit
18 its analysis to only the impact on existing competition are counter to the plain language in
19 Section 7-204(b)(6), which contains no such limitations. Further, such an interpretation
20 would make a mockery of the whole review process. The merger’s impact on future
21 market conditions is of obvious importance, particularly given the current situation with
22 local competition in its infancy. A merger that left the current miniscule amount of local

⁵⁴ GCI Ex. 2.0 at 64.

⁵⁵ SBC/AI Ex. 3.1 at 42-45.

1 competition intact but squelched all future competition would pass muster under SBC's
2 interpretation of Section 7-204(b)(6), an outcome that would clearly be counter to the
3 public interest.

4
5 Mr. Gebhardt's suggestion that only the FCC could determine whether Ameritech Illinois
6 has complied with Sections 251 and 252 of the 1996 Act is inexplicable, since the states
7 are charged with implementing these sections, with the scope of the FCC's jurisdiction
8 limited by the 1996 Act and confirmed by the courts. The Commission has undertaken
9 numerous proceedings as it has implemented these sections of the 1996 Act. While
10 inevitably there would be disagreement among the parties regarding the extent to which
11 Ameritech Illinois has complied with the statutory requirements, these are issues that
12 need to be resolved in order to ensure that competition is not harmed by the merger.
13 These issues are not new to the Commission and are clearly within the realm of its
14 jurisdiction and expertise. For these reasons, my earlier suggestion that the Commission
15 determine that Ameritech Illinois has complied with Section 251 requirements as a
16 condition of the merger remains appropriate and relevant.

17
18 Q. Please respond to Mr. Gebhardt's assertions that "(a)ny analysis of potential competition
19 undertaken by the Commission is ... likely to be highly speculative." and that "(p)otential
20 activity simply does not lend itself to sound regulatory analysis in this type of proceeding
21 and should have no applicability to the Commission's evaluation under Section 7-
22 204(b)(6)."⁵⁶

⁵⁶ Id., at 7.

1 A. Mr. Gebhardt's statements are odd, since a primary underpinning of SBC and Ameritech
2 Illinois' justifications for the merger is their planned National-Local Strategy. If planned
3 activities are not to be considered, then this whole portion of the Applicants' case should
4 be withdrawn.

5
6 The reality is that the Commission must evaluate the merger based on the best available
7 information, taking into account the reliability of the information. It is certainly wise to
8 exhibit a degree of skepticism regarding any company's statements regarding its future
9 plans, both because public pronouncements to regulators, the financial community, and
10 customers may or may not reflect top management's true intentions and because
11 corporate plans do not always come to fruition. This caution is as true for SBC and
12 Ameritech, as they attempt to convince regulators that a merger that appears to be in their
13 shareholders' best interest is also in the public interest, as it is for other companies.

14
15 A. Current Status of Local Competition

16
17 Q. Please respond to Ameritech Illinois' and SBC's updates regarding CLEC activity in their
18 service territories.

19 A. Mr. Gebhardt provides an update in Schedule 2 to his rebuttal testimony, stating that
20 "The data are similar to those provided in Ms. TerKeurst's testimony, only at a slightly
21 later point in time." He states that he includes an estimate of self-supplied CLEC lines,
22 but did not explain how this estimate was obtained.⁵⁷ Mr. Gebhardt's new Schedule 2
23 (which Ameritech Illinois has marked as proprietary) indicates slight increases in the

1 amount of both facilities-based and resale competition, relative to the data contained in
2 my direct testimony.

3
4 Mr. Gebhardt does not provide updated data regarding the number of unbundled network
5 elements that Ameritech Illinois provides. As I explained in my direct testimony, the
6 number of unbundled network elements being sold to CLECs is an important direct
7 indicator of the extent to which the incumbent carrier is providing interconnection and
8 access to its facilities on reasonable terms and conditions.⁵⁷ Without this crucial
9 information, the updated data provided by Mr. Gebhardt is of limited usefulness in
10 assessing Ameritech Illinois' progress in making its network accessible to CLECs.

11
12 In his rebuttal testimony, Mr. Kahan provides a similar update to data in his direct
13 testimony.⁵⁹ As in his direct testimony, Mr. Kahan does not provide the number of SBC
14 retail access lines, which are needed to put the CLEC data in perspective. Even using the
15 number of SBC retail lines (35,337,137) reported in my direct testimony for June 30,
16 1998,⁶⁰ Mr. Kahan's updated data shows CLEC facilities-based lines (including lines
17 provisioned with SBC UNEs) to equal only 1.1 percent of the access lines in SBC's
18 region,⁶¹ and that resold SBC lines constitute 2.0 percent,⁶² hardly stellar gains from the
19 time direct testimony was filed and still lagging significantly behind Ameritech Illinois.

20

⁵⁷ Id., at 28.

⁵⁸ GCI Ex. 2.0 at 45.

⁵⁹ SBC/AI Ex. 1.1 at 90.

⁶⁰ GCI Ex. 2.0 at 44.

⁶¹ $480,544 / (713,778 \text{ resold lines} + 480,544 \text{ CLEC lines} + 35,337,137 \text{ SBC retail lines})$.

⁶² $713,778 / (713,778 \text{ resold lines} + 480,544 \text{ CLEC lines} + 35,337,137 \text{ SBC retail lines})$.

1 Mr. Kahan provides separate data regarding the number of lines provisioned by CLECs
2 using unbundled loops purchased from SBC. It is interesting to note that the total number
3 of unbundled loops being provided in SBC's territory has declined slightly since June 30,
4 1998, based on a comparison of Mr. Kahan's new Table 2 to the data that SBC provided
5 to the Attorney General's office, as reported in my direct testimony.⁶³ While most SBC
6 states show increases in the number of unbundled loops, SBC reports a 9.2 percent
7 decrease in the number of unbundled loops being sold in California, from 52,092 as of
8 June 30, 1998⁶⁴ to a more recent tally of 47,275.⁶⁵ This alarming statistic does not bode
9 well for a post-merger Illinois.⁶⁶

10
11 While relying primarily on E-911 listings as an indicator of the number of facilities-based
12 CLEC access lines, Mr. Kahan constructs a separate estimate of the number of lines being
13 served by facilities-based CLECs based on interconnection trunks that have been
14 provided to CLECs. This method yields an estimated 1,146,099 facilities-based CLEC
15 lines, compared with an estimated 480,544 lines based on E-911 data.⁶⁷ In the Section
16 271 proceedings in Texas and California, SBC also relied on the number of
17 interconnection trunks as an indication of the presence of facilities-based CLEC activity.
18 In those proceedings, I examined the number of interconnection trunks that SBC was
19 providing and concluded that the number of interconnection trunks is not indicative of the
20 amount of local exchange competition.

⁶³ GCI Ex. 2.0 at 46.

⁶⁴ SBC response to Attorney General data request AG-30.

⁶⁵ SBC/AI Ex. 1.1 at 91.

⁶⁶ I note also that SBC witness C.H. Smith reports that Pacific Bell has provisioned over 80,000 UNEs (SBC/AI Ex. 6.0 at 14). While unclear, this appears to be a cumulative number. In combination with the current data reported by Mr Kahan in his Table 2, this implies that approximately 40 percent of the UNEs that have been provisioned are no longer in operation.

1
2 Interconnection agreements with BOCs often mandate more interconnection trunks than
3 are needed to provide local exchange service efficiently, e.g., by requiring that separate
4 trunks be used for originating and terminating traffic, for local and non-local traffic, or
5 for switched and non-switched traffic. Further, DID-based interim number portability
6 arrangements use interconnection trunks inefficiently. In my review in Texas and
7 California, it appeared that SBC may have included interconnection trunks used for long
8 distance traffic and private line services in the reported number of interconnection trunks,
9 since the reported number of trunks was vastly out of proportion with the number of
10 CLEC local access lines, particularly for specific CLECs for which I reviewed CLEC-
11 specific data.

12
13 Mr. Kahan provided no justification for his assumption that CLEC interconnection trunks
14 serve 2.75 facilities-based lines per interconnection trunks. Because of this and the other
15 problems I have identified with the use of interconnection trunks as an indicator of CLEC
16 activity, Mr. Kahan's estimate of 1,146,099 facilities-based CLEC lines is unreliable and
17 should be given no weight.

18
19 Q. Please comment on Dr. Harris' rebuttal testimony that CLECs currently "have access to"
20 66 percent of Ameritech Illinois' business customers.

21 A. Dr. Harris bases this statement on Attachment 1 of Staff witness Christopher L. Graves'
22 direct testimony as the basis for this statement,⁶⁷ which indicates that 66 percent of

⁶⁷ SBC/AI Ex. 1.1 at 90-91.

⁶⁸ SBC/AI Ex. 4.1 at 8.

1 Ameritech Illinois' business lines (or 1.9 million business lines) are served by central
2 offices at which one or more CLECs are currently collocated. This does not mean,
3 however, that CLECs are currently able to serve those 1.9 million lines. Various
4 constraints limit the CLECs' ability to serve lines even where collocation has occurred.
5 Ameritech Illinois has provided no information regarding the capacity of the collocated
6 interconnection facilities, or the availability of space in the central offices to add
7 additional collocation equipment, either by the already-collocated CLECs or by
8 additional CLECs that may wish to offer service within the exchanges. Further, even if
9 CLECs possess sufficient switching and other capacity, it is not clear that Ameritech
10 Illinois' OSS capacity could handle mass conversions at this time. As of June 30, 1998,
11 Ameritech Illinois was provisioning only 15,120 unbundled loops.⁶⁹
12

13 B. Effects of Corporate "Attitude" on Competition
14

15 Q. Has SBC said anything in its rebuttal testimony to alleviate your concerns regarding
16 SBC's corporate "attitude" toward competition?

17 A. No. SBC's unsurprising continued defense of its prior actions only serves as a foretelling
18 of what can be expected in Illinois. Mr. Kahan focuses on the criticisms raised by the
19 CLECs, stating "(l)et's consider who is making these allegations."⁷⁰ However, concerns
20 about SBC's corporate "attitude" have been raised uniformly by the parties in this
21 proceeding, including the Commission Staff. And SBC's activities have been denounced
22 elsewhere by a variety of governmental entities, including at least one district court, the

⁶⁹ GCI Ex. 2.0 at 46.

⁷⁰ SBC/AI Ex. 1.1 at 80.

1 Texas Commission, the Staff of the California Commission, the unions in California, and
2 consumer groups.

3
4 C. Effect of Merger on Competition in Illinois
5

6 Q. Do you agree with SBC about the value to Illinois if SBC were to offer local service in
7 competition with Ameritech Illinois?

8 A. No. Dr. Harris asserts that "(t)here is little to be gained from increased competition from
9 SBC in Chicago, and the existing players in Chicago are just as well, if not better,
10 situated to enter other markets in Illinois than SBC" and that "there is no basis for
11 concluding that SBC's entry [in Illinois] would have any incremental deconcentrating
12 effect."⁷¹

13
14 If there would be no benefit to SBC offering local service in competition with the ILEC
15 in Illinois, then what is the benefit of a combined SBC/Ameritech offering competitive
16 local service in other parts of the country? SBC appears to argue whichever side of the
17 coin suits its purpose. The reality is that SBC, with its expertise in providing local service
18 and the synergies of offering its existing local services to a wider geographic region,
19 would be a strong entry in the local arena. The merger would eliminate this possibility.

20
21 Q. Please respond to SBC's statements regarding one-stop shopping.

⁷¹ SBC/AI Ex. 4.1 at 15.

1 A. Mr. Kahan asserts that one-stop shopping is critical.⁷² If that is true, perhaps SBC's first
2 order of business should be to open up its local market so that it can obtain long distance
3 authority. Instead, SBC is attempting to enter the long distance market by having Section
4 271 declared invalid by the courts, so that it can obtain long distance authority without
5 having to open its local market. At the same time, it is pursuing this merger, which
6 would help it strengthen its grip on the local market. If this two-fisted strategy succeeds,
7 SBC will have created a situation in which it is the only carrier offering one-stop
8 shopping to the vast majority of customers in Illinois, while decreasing the likelihood that
9 that other carriers will be able to compete successfully.

10
11 Q. Would undertaking the National-Local Strategy create incentives for a post-merger SBC
12 to resist opening the local market in Illinois?

13 A. Yes. If CLECs are unable to operate profitably in Illinois, they will be weaker and, thus,
14 less able to compete with SBC in the out-of-region markets SBC seeks to enter through
15 the National-Local Strategy. Because of this, a post-merger SBC would have more
16 incentives to impede access to its local network in Illinois than if it were not pursuing the
17 National-Local Strategy. This is just one more reason why the proposed merger should
18 not be approved until Ameritech Illinois' local markets are fully opened.

19
20 Q. Please respond to Mr. Gebhardt's view that wholesale rates may decline as a result of the
21 merger.

22 A. Mr. Gebhardt states that, while it is not clear whether merger savings would affect resale
23 costs and rates, "if there were an effect, ... it would almost certainly be in a downward

⁷² SBC/AI Ex. 1.1 at 50.

1 direction.”⁷³ Mr. Gebhardt provides no basis for this statement, which doesn’t comport
2 with the way in which wholesale rates are set. Wholesale rates are set by calculating a
3 percent reduction from retail rates based on the retail costs that can be avoided. If the
4 merger does fulfill its promise of increased operating efficiencies and cost reductions, it
5 follows that the retail costs to be avoided due to the sale of wholesale services would
6 decline. If this result is reflected in updated cost studies, one would expect likewise that
7 the wholesale discount would decline commensurately. Mr. Gebhardt provides no
8 justification for his opinion that any change in wholesale rates as a result of the merger
9 would be a decrease. To the contrary, an increase in wholesale rates would narrow the
10 already narrow margins between wholesale and retail rates, making resale even less
11 viable than it is today.

12
13 D. Need for Competitive Safeguards

14
15 Q. Please respond to SBC’s criticism of your recommendation that, if the merger is

16 approved, SBC not be allowed to change Ameritech Illinois’ policies in ways that would
17 affect local competition without the consent of the affected CLECs or the Commission’s
18 approval.

19 A. Mr. Kahan argues that this condition would be neither appropriate nor useful, on the basis
20 that SBC would not have the ability to unilaterally alter existing interconnection
21 agreements anyway. He states that, if changes in policies affect interconnection

⁷³ SBC/AI Ex. 3.1 at 27.

1 agreements that have not been signed, the parties can negotiate and, if necessary, request
2 Commission arbitration.⁷⁴

3
4 I agree that SBC could not modify the plain terms of an interconnection agreement.
5 However, much of the value of an interconnection agreement lies in the way in which it
6 is interpreted and implemented. The functioning of an interconnection agreement
7 depends on predictable and consistent implementation of the "between the lines" details
8 and this is where my primary concern lies. I described in my direct testimony an instance
9 in which Bell Atlantic changed its interpretation of interconnection agreements after it
10 acquired NYNEX, in particular regarding the assignment of contracts to resellers without
11 imposition of termination penalties.⁷⁵ As I explained, the stage is set for a similar post-
12 merger change in ILEC policy in Illinois, since data requests showed that Ameritech
13 Illinois and SBC policies differ on this matter of interpretation. My proposed condition is
14 needed to ensure that SBC does not come in and overturn Ameritech Illinois policies,
15 with this protection needed particularly for areas that may not be clearly spelled out in
16 interconnection agreements.

17
18 SBC could also unilaterally change its OSS policies to the detriment of CLECs. SBC
19 witness Christopher J. Viveros argues that this proceeding is not the proper forum for
20 developing OSS change management processes.⁷⁶ He attempts to reassure the
21 Commission that SBC would "weigh the mutual CLEC and SBC benefits of corporation-
22 wide interfaces with the unique requirements of the individual operating regions" before

⁷⁴ SBC/AI Ex. 1.1 at 110.

⁷⁵ GCI Ex. 2.1 at 50-51.

1 standardizing OSS processes among the states, and would follow a Change Management
2 Process that would give CLECs an opportunity to comment and a "reasonable period of
3 time ... to make any necessary changes to their own interfaces and processes to prevent
4 negative impacts to their service."⁷⁷ If SBC and the CLECs agree on OSS
5 standardization, that is well and fine. However, a unilateral change to Ameritech Illinois'
6 OSS could create CLEC service problems, customer dissatisfaction, and expenses that
7 after-the-fact litigation before the Commission could not rectify. My recommendation
8 that SBC not be allowed to unilaterally change Ameritech Illinois policies in a manner
9 unacceptable to CLECs would prevent these harmful consequences.
10

11 Q. In your direct testimony, you recommended that SBC and Ameritech Illinois be required
12 to provide quality of service commitments to CLECs. Do you agree with Mr. Kahan's
13 statement that interconnection agreements already contain the necessary and appropriate
14 performance measures?

15 A. No. Mr. Kahan makes an unexplained connection between SBC's agreement to track a
16 list of performance measures for the DOJ and interconnection agreements, stating that
17 "(i)n light of the fact that these performance measurements have been specifically
18 approved by the Department of Justice, we believe that we clearly provide the necessary
19 and appropriate performance measures in our interconnection agreements."⁷⁸ Mr. Kahan
20 does not explain how monitoring the performance measurements for DOJ purposes leads
21 to their being incorporated into interconnection agreements.
22

⁷⁶ SBC/AI Ex. 7.0 at 31.

⁷⁷ Id., at 29-30.

1 The DOJ performance measures, while useful, have some shortcomings. SBC has made
2 no commitment to continue tracking the measurements after SBC has obtained what it
3 wants from the DOJ: a favorable position on a Section 271 application. Further, there do
4 not appear to be standards established for the various measurements, to aid in an
5 assessment of the reasonableness of SBC's performance. There do not appear to be any
6 means by which CLECs could be compensated if SBC provides inadequate service, or
7 any other financial incentive for SBC to provide quality service (once long distance relief
8 is obtained). And SBC has not committed to tracking and reporting the same
9 measurements in Illinois if its merger with Ameritech Illinois is approved. While the
10 performance measurements developed by the DOJ appear very valuable, these changes
11 are needed if the performance measurements are to be useful in Illinois.

12
13 Q. Please respond to Mr. Kahan's assertion that there are problems with your
14 recommendation that multi-location contracts be subject to resale at wholesale prices.

15 A. Mr. Kahan asserts that the Commission lacks the authority to require Ameritech Illinois
16 to offer services provided outside of Illinois at wholesale prices.⁷⁹ I have not made that
17 assertion and do not disagree with him on that point. However, the fact that SBC may
18 wish to provide service on a multi-state basis in no way excuses it from the requirements
19 in the 1996 Act that it make its retail services available at wholesale rates, nor from the
20 federal and state interpretations that these requirements apply to services offered via
21 contracts as well as to tariffed services. SBC should not be allowed to avoid these
22 statutory and regulatory requirements through the use of multi-state contracts.

⁷⁸ SBC/AI Ex. 1.1 at 87.

⁷⁹ Id., at 114.

IV. REFLECTION OF MERGER BENEFITS IN RATES—SECTION 7-204(c)

Q. Please respond to other parties' testimony regarding how merger benefits could be allocated to customers.

A. Staff witness Rasha Toppozada-Yow recommends that Ameritech Illinois develop retail promotions for noncompetitive, non-discretionary services, with the promotions also reflected in their counterpart wholesale rates.⁸⁰ While opposing the allocation of any merger benefits to customers, Mr. Gebhardt suggests that a one-time credit on customers' bills would better accomplish the Staff's objectives. Mr. Gebhardt takes issue with the Staff's condition that the promotion apply only to noncompetitive, non-discretionary services, questioning what the Staff means by non-discretionary and pointing out that all business services state-wide and all residence services in a limited number of exchanges have been declared competitive. Mr. Gebhardt comments that network access lines have the poorest rate-cost relationship of any of Ameritech Illinois' major service categories and suggests that flowing through the merger savings to more profitable services would be more economically sound and more consistent with the Commission's pricing policies. He questions how a promotion could be fashioned for IXC or UNE services, and asserts that a promotion that reduced UNE prices below cost could be counter to the requirement in the 1996 Act that UNEs must be priced at cost and, if cost studies are updated to reflect merger savings, could result in a double benefit to UNE customers.⁸¹

⁸⁰ ICC Staff Ex. 3.0 at 28-30.

⁸¹ SBC/AI Ex. 3.1 at 85-89.

1
2 Mr. Gebhardt states that I am proposing the same equal percentage distribution of flow-
3 through savings to customer groups as the Staff and that it is unworkable for all of the
4 same reasons.⁸²

5
6 While one-time promotions or credits may be an acceptable way to share merger benefits
7 with customers, the proposal that Dr. Selwyn and I have recommended, in which merger
8 benefits would be reflected through on-going rate reductions for a ten-year period is more
9 workable. Unless the amount of merger benefits to be shared is very small, one-time
10 promotions or credits could cause large distortions in a customer's bill, with rates going
11 below forward-looking costs and possibly even to zero (or below). An on-going rate
12 reduction would better reflect that Ameritech Illinois will achieve permanent cost
13 reductions and synergy benefits due to the merger; with customers sharing in those
14 benefits on an on-going basis.

15
16 Under the approach recommended by Dr. Selwyn and me, merger benefits would be
17 allocated between noncompetitive services and those services classified as competitive,
18 as explained by Dr. Selwyn. Unlike the Staff's approach, the amount of merger benefits
19 to be reflected in the rates for any particular noncompetitive service would not be
20 affected by the classification of other services and would not be affected by the current
21 disputes regarding the proper classification of certain services. Mr. Gebhardt may not
22 have understood this difference between this approach and the Staff's approach, since it
23 avoids one of the problems that he raises with the Staff's approach.

1
2 Our approach requires that the merger benefits flow to all non-competitive services. It
3 does not draw a distinction between discretionary and non-discretionary services,
4 between making it more workable and less controversial than the Staff's approach in this
5 respect. Nor would we draw a distinction based on the relationship between a service's
6 rates and its costs. Such an approach, which Mr. Gebhardt suggests, should be rejected
7 because it would work to Ameritech Illinois' strategic benefit and would be difficult to
8 craft.

9
10 The approach that I recommend would reflect merger benefits in UNE rates through
11 updated cost studies, avoiding the concerns Mr. Gebhardt raised regarding the Staff's
12 UNE proposal.

13
14 In sum, the approach I recommend for sharing merger benefits, as described in detail in
15 my direct testimony, benefits all customers, furthers competition, is workable, and is easy
16 to implement.

17
18 Q. Please respond to other parties' testimony regarding the updating of Ameritech Illinois
19 cost studies.

20 A. Ms. Yow recommends that the Commission require Ameritech Illinois to file updated
21 LRSIC, TELRIC, and shared/common cost studies within six months after the merger is
22 approved.⁸² Mr. Gebhardt asserts that a six-month requirement would be unreasonable

⁸² SBC/AI Ex. 3.1 at 89-90.

⁸³ ICC Staff Ex. 3.0 at 41-43.

1 and proposes that Ameritech Illinois and the Staff work together informally to prioritize
2 the studies that need to be updated.⁸⁴ He recommends that, in the meantime, existing
3 dockets proceed based on currently available information.⁸⁵
4

5 While recognizing the complexity of cost studies, I am concerned that Mr. Gebhardt's
6 approach is open-ended and would allow Ameritech Illinois to delay completion of the
7 cost study updates indefinitely. If the merger is approved, it is important that the
8 Commission set a date certain by which the new cost studies must be completed.

9 However, it would be reasonable to set the completion date six months after the date that
10 the merger is consummated, rather than the date that the Commission approves the
11 merger.
12

13 Q. Does this conclude your rebuttal testimony?

14 A. Yes, it does.

⁸⁴ SBC/AI Ex. 3.1 at 118-119.

⁸⁵ Id., at 120.